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C O N F I D E N T I A L SECTION 01 OF 09 KABUL 001022

SIPDIS

NSC FOR ZKHALILZAD, JDWORKEN, HMANN, RHANSON, DSEDNEY  
DEPT FOR SA/PAB, SA/AR  
MANILA PLEASE PASS AMB PSPELTZ  
USDOC FOR DAS/TD MURPHY AND AFGHAN RECON TASK FORCE  
STATE PASS USAID FOR JPRYOR  
STATE PASS TDA FOR DSTEIN AND JSUSSMAN  
STATE PASS TREASURY FOR U/S TAYLOR, LMCDONALD  
STATE PASS OPIC FOR RCONNELLY AND DZAHNHEISER

E.O. 12958: DECL: 04/19/2013

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SUBJECT: AFGHANISTAN TELECOMMUNICATIONS SECTOR UPDATE -  
APRIL 2003

Classified By: AMBASSADOR ROBERT P. FINN FOR REASONS  
1.5 (B) AND (D)

**¶11. (C)** The Ministry of Communications (MOC) is facing an assortment of challenges as the government of President Karzai enters the Afghan year 1382. The Ministry's relations with its sole telecom service provider, Afghan Wireless Communications Company (AWCC), continue to deteriorate while a second service provider led by the Aga Khan Fund for Economic Development (AKFED), is preparing to launch operations. The Ministry of Communications is planning to unveil yet another strategy for developing a transparent and progressive telecom sector in early May which may even include plans for partial privatization of this sector. For now, the government has decided to take a wait-and-see approach to privatization generally. The Afghan government cites national security, national prestige, and instability caused by dislocation of public workers as factors in delaying privatization. Ironically, two different roads to partial privatization for telecoms are available - both with little to no political risk. An AWCC buy-out of the MOC's 20 percent share of its stock, or MOC taking on a minority partner to help modernize and expand Afghanistan's state-owned telecom sector both offer safe, albeit limited, privatization opportunities. Meanwhile, the MOC is preparing to issue two new invitations to tender in coming weeks. End summary.

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Background on Afghan Telecom Sector  
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**¶12. (SBU)** The existing service provider, Afghan Wireless Communications Company (AWCC), began service in Afghanistan in 1998 as Telephone Systems International (TSI). TSI contracted their Afghan operations out to a U.K. firm during the Taliban sanctions period from 1999 to 2001. In 2001, the Rabbani government (based probably upon its legal standing as holder of Afghanistan's UN seat and most of its embassies around the world, although at the time it controlled perhaps only 15 percent of Afghanistan's territory) ratified TSI's license. AWCC was then formed in 2001 to operate the wireless telecom (GSM) system. It was (and still is) 80 percent owned by TSI and 20 percent owned by the MOC.

**¶13. (C)** After a highly controversial bidding process for a second Generalized System for Mobiles (GSM) license in the latter half of 2002, (which involved the abrupt cancellation of the first invitation to tender and allegations of bribery, kickbacks, conflicts of interest and non-transparent tendering on the second invitation to tender), the MOC awarded a license to the AKFED consortium (which included the Aga Khan Foundation as its largest stakeholder). According to AWCC, which did not bid on the second GSM license, the MOC notified AWCC during this lengthy bidding process that their license would no longer be exclusive and must be modified to reflect terms identical to those in the AKFED license.

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AWCC Claims Effective Expropriation of Assets by MOC  
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**¶14. (C)** Officials from the Afghan Wireless Communications Corporation met with the Ambassador on April 4 to voice their growing concerns about their troubled relations with the MOC and seek his help. Relations between AWCC and the MOC have been strained during the entire tenure of Communications Minister Stanakzai as reported previously. Now, according to AWCC officials, the Ministry had imposed severe conditions on AWCC for license renewal, and had established a seemingly arbitrary April 23 deadline for compliance. The provisions the MOC is seeking as conditions for license renewal include: Dissolution of the existing license; transfer of an additional 20 percent ownership stake to MOC without compensation (raising the MOC's ownership share in AWCC to 40 percent); transfer of one-third of international incoming

call revenues; control of the AWCC Board of Directors; authority to appoint AWCC management; the settlement of an existing legal dispute between AWCC/TSI and its former U.K. subcontractor and several other taxes and conditions. The AWCC reps asserted they are facing far more stringent conditions than AKFED did. They were unable to confirm this disparity, however, as the MOC has not allowed AWCC to review the AKFED license.

15. (C) AWCC claims 35,000 subscribers, operates in four cities with another pending, (Jalalabad service is reportedly being held up by the MOC), has made a claimed \$70 million investment in the GSM network, employs over 600 local employees, and creates a \$500,000 monthly expenditure in the local economy. Substantial upgrading and expansion are planned for 2003. The AWCC reps claimed that the MOC's actions constitute a partial expropriation of their substantial private investment in Afghanistan. They further claimed that the attorneys representing the MOC are very unsophisticated regarding telecommunications regulation and practice, and did not even realize the sum of their actions constituted effective expropriation until they were advised of this outcome. Based upon the urgency of their situation and their investment at stake, they requested the Ambassador speak with appropriate Afghan government officials to prevent this pending expropriation. Otherwise, they claimed they would have no alternative but to cease further investment and pull out of Afghanistan. (Note: With the AKFED Consortium still months away from commencing operations, this would leave Afghanistan with virtually no phone service at all for the near term. End note.)

16. (C) The AWCC reps noted that Minister Stanakzai, despite trying to reach some compromise, appeared unable to balance his conflicting roles as policy-maker, government official, regulator, and shareholder. They suggested one solution would be for the government to sell their 20 percent ownership stake to AWCC and get out of the business side of telecommunications entirely. This *&de facto*8 partial privatization could send a positive signal to international investors.

17. (C) The Ambassador raised the issue of possible expropriation during a meeting with President Karzai on April 14. Karzai was alarmed and understood the disastrous effect an expropriation would have on Afghanistan's potential to attract foreign investment. The Ambassador raised the possibility of *&privatizing*8 the MOC's 20 percent ownership stake in AWCC through sale to AWCC. President Karzai agreed that privatization was a good idea for telecoms and wondered why the Afghan government was involved in this sector at all. Nonetheless, it was unclear what action President Karzai was prepared to take.

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TDA-funded Consultant Bashesh  
AWCC, Discusses Privatization,  
and Notes Upcoming Tenders  
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18. (C) On April 10, Econ/Commooff met with Ken Zita, (please protect) a TDA-funded telecom advisor to the Ministry of Communications, to review sector developments. When the subject of AWCC was raised, Zita said AWCC was *&probably* the worst phone company anywhere in the world8. He strongly disputed AWCC's claim of a 98 percent call completion rate. (Note: Embassy can confirm that. For whole days there is no AWCC service at all; other days perhaps one-third of calls made do not get through. The joke around Kabul is AWCC stands for *&Always Waiting, Can't Connect*8. End note.) Zita maintained that the poor performance of AWCC had become a major liability and embarrassment to the Afghan government. Contrary to AWCC's claims that it has tried to cooperate with the Ministry of Commerce, Zita said AWCC had failed to rectify *&insignificant*8 problems with the wireless network, despite being *&put* on notice8 as early as July 2002 by the MOC. He reported just having come from a meeting between the Minister and AWCC reps in which the Minister *&escalated*8 matters. Stanakzai reportedly gave AWCC 20 days to comply with the MOC conditions or their license would be revoked. Zita noted that he had kept an open mind about AWCC since he first visited Afghanistan in April 2002, but that his opinion of the firm had declined steadily.

19. (C) According to Zita, AWCC had not accomplished enough in the past year, offered poor and relatively expensive service, and *&no* one believes they've actually invested as much as they say they have8. To increase the public pressure on AWCC, Minister Stanakzai announced publicly on April 14 that AWCC has three months to improve service or have their license revoked. According to other Kabul sources, to drive home the message, one of AWCC's management was detained on April 13 by the Ministry of Defense and ordered to improve service within ten days or face arrest. Minister Stanakzai denies his Ministry was involved in the MOD action. (Note: Of course, AWCC maintains that MOC obstruction and lack of

support from the MOC were a major obstacle to their operations. It is worth noting Zita was unaware and surprised that the MOC had refused to show AWCC the AKFED contract their license conditions were to match. This last point is especially important if AKFED turns out to be 100 percent privately owned. This would greatly strengthen the AWCC position for buying out the MOC's 20 percent share. End note.)

¶10. (C) Turning to more positive matters, Zita noted that two telecom invitations to tender were scheduled to be announced in roughly two to three weeks. The first tender would request bids for a management contract to establish a wireless local loop system in 11 cities. The second tender was for the establishment of an International Satellite Gateway system. (Note: As further information on these tenders becomes available, Embassy will pass along. For the time being, relevant Washington agencies are requested to inform potentially interested U.S. firms. Endnote.)

¶11. (C) Econ/Commooff asked if the MOC had any plans to privatize Afghanistan's telecom sector holdings ) which the Ministry would like to run as an independent SOE named &AfghanTel8. AfghanTel would maintain the existing 40,000 landlines and 5,400 public employees (Comment: One employee for every 8 phones ) incredible! End comment.) Zita said he had advised the Minister that the Afghan telecom sector should be privatized, but noted that the Minister wanted to maintain state control. The reasons he cited were: first, national security; second, national branding (i.e., prestige), and third, the desire to avoid any dislocations caused by widespread layoffs in the run-up to elections. The International Telecommunications Union advisor working with the Minister, Mr. Sangin, also opposed near-term privatization of telecoms.

¶12. (C) Zita suggested that private firms would probably have no interest in taking ownership of the existing telecom structure of AfghanTel. Severance packages for displaced workers could even be included in private bids for telecom operations. Most importantly, however, AfghanTel's real value was its land holdings, which included 423 post offices, switching stations and rights-of-way throughout the country. Access to such land would offer tremendous commercial opportunities in telecommunications and other sectors for prospective bidders. Despite the capacity to raise substantial assets and improve service through the privatization of AfghanTel, strong resistance remained.

¶13. (C) Econ/Commooff noted that it was hard to see where the telecom sector was headed, and asked Zita if there was a plan for future development of the sector. Zita replied that he was working on such a plan for presentation to the Minister by the end of April and would suggest publication of the new policy in mid-May.

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Future Options for Afghan Telecoms:  
Early Partial Privatization Suggested

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¶14. (SBU) On April 13, Zita sent an e-mail to the Minister and his advisors at the MOC outlining &Options for AfghanTel8 and provided a copy to the Embassy. The e-mail details the difficulties facing AfghanTel within an open and competitive marketplace and is summarized here to indicate the aspects of the internal dialogue going on within the Afghan Ministry of Communications. Zita notes AfghanTel will require investment capital to match its private sector competitors, and will be unlikely to raise these funds through either private borrowing or donor assistance. Zita added that the ITU advisor, Mr. Sangin has suggested privatizing a minority position in AfghanTel &over time8, without a specific timetable. Zita warned that if AfghanTel enters the market - especially with only limited financial resources - any failure to perform ) or to compete effectively ) might have a direct, negative impact on the credibility of the government.

¶15. (C) Zita continued, noting that engaging a management partner would offset operational risk and improve generation of cash. Zita acknowledged that maintaining majority state ownership of AfghanTel is politically important (for the reasons outlined above). Under the circumstances, Zita recommended the immediate sale of a minority interest in AfghanTel (to a firm able to provide management and/or technical expertise and access to capital) as an alternative to a &wait-and-see8 timetable for privatization. In this immediate partial privatization scenario, the investor would purchase a minority block of shares (25 percent) with an option to purchase up to 49 percent (or more) in the future. Zita concluded that telecom is &almost always a privatization pioneer in any country8 and that &no other sector is better suited to lead the way8.

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Comment

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¶16. (C) Appropriate development of the Afghan telecom sector could serve as a major revenue and job generator for the fragile Afghan government. Privatization in telecom could also help generate revenue and smooth the path for future partial or full state-owned enterprises (SOE) privatizations.

The Afghan Cabinet reportedly debated privatization of telecoms on April 12 and decided to wait for the present. While the result is not what we had hoped, the fact that such a Cabinet debate took place is a healthy sign. The merits of privatization versus continued state control are being actively considered at the MOC, although it remains unclear whether economic or political considerations are paramount. While a partial expropriation of AWCC/TSI would represent a disaster for Afghanistan's image, a partial privatization of AfghanTel would be a major boost.

¶17. (C) The MOC allowing AWCC/TSI to buy out their 20 percent share would enhance perceptions of Afghanistan's business climate even further. Perhaps the notion of allowing AWCC/TSI to buy out the 20 percent stake would face resistance in light of AWCC's alleged poor performance over the past year. AWCC's position will be considerably strengthened, however, if it turns out AKFED's license conditions include 100 percent private ownership. The privatization<sup>8</sup> of the 20 percent MOC share of AWCC would be virtually without political risk as all AWCC employees are private and not public employees. AWCC has even agreed, if national branding/prestige is a consideration, to change their name to remove the identification with Afghanistan.

¶18. (C) There is at least some reason to hope a more progressive and transparent telecom policy will be enacted soon and that the stated goal of delineating the MOC's current multiple roles and possible scenarios for at least some telecom privatization will be part of this urgently needed reform. If so, a fully private AWCC/TSI and a partially privatized AfghanTel would have to compete in an open telecom market with new entrants, improving telecom service and access for the Afghan population. The Embassy will continue to advocate strongly for privatization and open competition as general themes, and particularly focus our privatization message on the Afghan telecom sector.

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